

Message Text

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FOR AMB ENDERS

E.O. 11652: N/A

TAGS: EMIN

SUBJECT: POTASH SUPPLY ASSURANCES

REF: (1) OTTAWA 2870; (2) WINNIPEG 247

1.BEGIN SUMMARY. AS REQUESTED IN REFTEL 1, DEPARTMENT AND OTHER AGENCIES HAVE CONSIDERED NOTION OF "SUPPLY ASSURANCES/ WHICH PREMIER BLAKENEY RAISED WITH YOU RECENTLY. SINCE THE CONFIDENTIAL

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US NOW RELIES UPON SASKATCHEWAN FOR OVER HALF OF OUR POTASH SUPPLY, SECURITY OF SUPPLY IS AN IMPORTANT CONSIDERATION. MOREOVER, IF GOS USED A COMMANDING MARKET POSITION TO CONTROL POTASH PRICES AND OUTPUT, IT COULD THREATEN THE FUTURE

PIPELINE TO THE US. NEVERTHELESS, WE ARE NOT PERSUADED THAT US INTERESTS COMPEL A BILATERAL SUPPLY ASSURANCE ARRANGEMENT WITH REGINA, SINCE US DEPENDENCE ON SASK POTASH MAY NOT BE AS CRITICAL AS CURRENT TRADE FIGURES SUGGEST. BEYOND THAT BASIC QUESTION, WE CANNOT ENVISION A GOVERNMENT-TO-GOVERNMENT TYPE OF SUPPLY ARRANGEMENT WORKING SUCCESSFULLY, SINCE IT WOULD EITHER CONSTRAIN PRIVATE US BUSINESS FROM SEEKING THE LOWEST MARKET PRICES OR, ALTERNATIVELY, INVOLVE THE USG IN THE UNNECESSARY ROLE OF BUYING AND SELLING POTASH. IT DID OCCUR TO US, HOWEVER, THAT A UNILATERAL SUPPLY ASSURANCE FROM REGINA MIGHT HAVE MERIT FROM BOTH THE US AND SASK STANDPOINTS. SUCH A DECLARATION--TO PROVIDE A SPECIFIED MINIMUM AMOUNT OF POTASH OVER A SPECIFIC TIME PERIOD, AT OR BELOW AN AGREED SELLING PRICE--WOULD NOT BIND THE USG, WOULD PRESERVE US BUSINESS DISCRETION, AND COULD RESTORE CONFIDENCE IN SASK RELIABILITY AS A SUPPLIER. SHORT OF SOME SASK INITIATIVE, WE WOULD PREFER NO ASSURANCES AT ALL, EXCEPT AS PRIVATE AMERICAN FIRMS MAY FREELY CONTRACT WITH GOS. WE WOULD WELCOME YOUR ANALYSIS OF THIS POSSIBLE COURSE. INFORMAL DISCUSSIONS WITH GOS ON SUPPLY AND ACCESS QUESTIONS IN NO WAY ALTERS USG CONCERN WITH THE INVESTMENT ASPECTS OF GOS ACTIONS OR ITS OBLIGATIONS TO US COMPANIES. END SUMMARY.

2. RELATIVE DEPENDENCE-US AND SASKATCHEWAN. IN 1975, SASK POTASH PRODUCTION WAS 6 MILLION SHORT TONS (K₂O EQUIVALENT), OF WHICH 3.5 MILLION ST--OR 58 PERCENT--WAS SHIPPED TO THE US, 1.4 MILLION ST EXPORTED ELSEWHERE, AND 1.1 MILLION ST CONSUMED DOMESTICALLY OR STOCKPILED. THE PRINCIPAL POTASH CONSUMERS OUTSIDE OF NORTH AMERICA--WESTERN EUROPE, EASTERN EUROPE AND THE USSR--HAVE AMPLE LOCAL POTASH RESOURCES. AMONG THESE COUNTRIES, THE USSR, EAST AND WEST GERMANY ARE MAJOR NET EXPORTERS, AND THE FIRST TWO ARE RAPIDLY EXPANDING PRODUCTION CAPACITY. CANADIAN POTASH EXPORTS TO EUROPEAN MARKETS HAVE BEEN DETERRED BY HIGHER FREIGHT COSTS RELATIVE TO OTHER EUROPEAN SUPPLIERS. CANADA'S SECOND LEADING CUSTOMER IS JAPAN (500,000 ST IN 1975), FOLLOWED BY BRAZIL. WHILE POTASH DEMAND IN THOSE TWO COUNTRIES AND IN THE DEV-
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EVELOPING ECONOMIES COULD DOUBLE IN THE NEXT DECADE, THEY WILL STILL REPRESENT ONLY ABOUT 15 PERCENT OF TOTAL WORLD CONSUMPTION. IN SHORT, CANADA WILL CONTINUE TO RELY ON THE US AS THE OUTLET FOR MOST OF ITS POTASH PRODUCTION, WITH ONLY MARGINAL OPPORTUNITIES FOR DIVERSIFYING MARKETS.

3. THE US, ON THE OTHER HAND, CAN IF NECESSARY REDUCE ITS HEAVY DEPENDENCE ON CANADIAN POTASH, ALTHOUGH THE ADJUSTMENT PROCESS MIGHT TAKE 3-5 YEARS. VIRTUALLY ALL IMPORTED POTASH NOW COMES FROM CANADA, ACCOUNTING FOR OVER HALF OF US SUPPLY. DOMESTIC PRODUCTION, MAINLY IN THE CARLSBAD AREA, SATISFIES A THIRD OF DOMESTIC DEMAND; ABOUT 30 PERCENT OF US OUTPUT IS EXPORTED. THE CARLSBAD DEPOSITS ARE

SMALLER AND MORE COSTLY TO EXPLOIT THAN THOSE IN SASK, BUT THEY SHOULD CONTINUE TO PROVIDE A MAJOR SOURCE OF US POTASH.

4. THE MOST IMPORTANT POTENTIAL FOREIGN SOURCES OF POTASH BESIDES CANADA ARE EASTERN EUROPE AND THE SOVIET UNION. BY 1980 THAT REGION MAY HAVE AN 18 MILLION ST PRODUCTION CAPACITY--50 PERCENT OF THE WORLD TOTAL (TVA ESTIMATE)--AND AN EXPORT SURPLUS OF 5-6 MILLION ST. HIGH FREIGHT COSTS HAVE IMPEDED SIGNIFICANT SOVIET ENTRY INTO THE US MARKET. BUT RECENTLY, AGRICO-WILLIAMS AND OCCIDENTAL HAVE REPORTEDLY BEEN MOVING CLOSE TO POSSIBLE SWAP ARRANGEMENTS OF FERTILIZER PRODUCTS--E.G., SOVIET POTASH FOR US SUPER PHOSPHATE. IN THEIR EAGERNESS TO EXPAND EXPORTS, THE SOVIETS HAVE HINTED OF FREIGHT SUBSIDIES TO LOWER LANDED COSTS FOR THEIR POTASH SHIPMENTS. A DETERIORATING INVESTMENT CLIMATE IN SASK, CAUSING CANCELLATION OF PLANNED CAPACITY EXPANSION BY PRIVATE FIRMS, COULD LEAD TO A SHIFT IN US TRADE TOWARD THE USSR. ACCORDING TO SOME TRADE SOURCES, UP TO ONE MILLION TONS OF SOVIET POTASH COULD BE COMING INTO THE US BY 1978.

5. IN ADDITION, US POTASH RESOURCES COULD BECOME MORE ATTRACTIVE. EXPLORATORY DRILLING BEGAN THIS YEAR IN THE MONTANA-NORTH DAKOTA AREA NEAR THE SASK BORDER. SEVERAL AMERICAN FIRMS ARE REPORTEDLY PLANNING LARGE INVESTMENTS IN SOLUTION MINING. ALTHOUGH THE DEPOSITS IN THIS AREA ARE ABOUT TWO MILES DEEP (CF, AVERAGE 3,000 FEET DEPTH OF SASK DEPOSITS), THEY ARE AN EXTENSION OF THE SASK DEPOSITS. STILL CONFIDENTIAL

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ANOTHER POTENTIALLY VIABLE SOURCE OF POTASH IS THE RECENTLY DISCOVERED DEPOSITS IN NEW BRUNSWICK, CANADA. THESE BEDS CONTAIN RICH SILVANITE ORE, ABOUT 30 PERCENT K₂O, AT A DEPTH OF ABOUT ONE-HALF MILE.

6. THE US, THEREFORE, APPEARS LESS DEPENDENT ON SASK AS A POTASH SUPPLIER THAN IS SASK ON THE US AS A CUSTOMER. SASK DOES HAVE THE RICHEST, MOST ACCESSIBLE AND LOWEST COST POTASH RESERVES IN THE WORLD. BUT GOS PRICING AND OUTPUT POLICIES COULD OFFSET THEIR NATURAL ADVANTAGE, MAKING OTHER SOURCES MORE ECONOMICAL TO TAP.

7. SUPPLY ASSURANCES. THE FOREGOING ANALYSIS OF RELATIVE DEPENDENCE DETERMINES OUR ATTITUDE TOWARDS POSSIBLE SUPPLY ARRANGEMENTS WITH REGINA AND LEADS US TO QUESTION THE VALUE OF BILATERAL ARRANGEMENTS WHICH COMMIT THE US TO SPECIFIC PURCHASE AMOUNTS, PRICES, AND TIME FRAMES. CURRENT AND PROJECTED PRODUCTION PATTERNS WORLDWIDE DO NOT CONFINE US TO A SINGLE OUTSIDE SUPPLIER OF POTASH. ALTHOUGH THE RELATIVELY LOW PRICE OF SASK POTASH IN THE PAST HAS MADE IT THE MOST ATTRACTIVE SOURCE FOR THE US, WE ARE NOT LOCKED IN TO THAT CHANNEL, ESPECIALLY IF FUTURE PRICE RELATIONSHIPS CHANGE.

MOREOVER, A GOVERNMENT-TO-GOVERNMENT AGREEMENT PRESENTS OPERATIONAL PROBLEMS FOR US. WHILE THE GOS WOULD BE THE SELLER, BUYERS IN THE US WOULD BE IN THE PRIVATE SECTOR. IF GOS PRICES ARE ABOVE WHAT US BUYERS ARE WILLING TO PAY, OUR PRIVATE COMPANIES WOULD BE ALLOWED TO REACT FREELY, WITHOUT USG INTERVENTION, TO SEEK OTHER SOURCES OF SUPPLY. CLEARLY THE USG CANNOT BLOCK (AND SHOULD NOT SEEK TO BLOCK) CONTRACT ARRANGEMENTS BETWEEN THE SASK GOVERNMENT AND US COMPANIES. BUT THE USG ITSELF SHOULD NOT BE AN ACTIVE PARTNER TO AGREEMENTS WITH REGINA.

8. CONSIDERING THE MEDIUM TERM OUTLOOK FOR CONTINUED AMPLE POTASH SUPPLY AND FAIRLY STABLE PRICES, THE US SHOULD SEEK TO PRESERVE AND PROMOTE A COMPETITIVE POTASH MARKET. THE USG MIGHT ADVANCE THAT OBJECTIVE BY SUGGESTING THAT GOS OFFER A UNILATERAL SUPPLY ASSURANCE THAT WOULD NOT BIND EITHER THE USG OR PRIVATE SECTOR. THAT IS, GOS WOULD MAKE A GENERAL SALES GUARANTEE TO THE US, SPECIFYING SELLING PRICES, MINIMUM QUANTITIES, AND A TIME PERIOD. PRIVATE US BUYERS
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WOULD RETAIN FREEDOM TO SELECT SUPPLIERS AND ENTER INTO PURCHASE CONTRACTS IN OR OUTSIDE OF SASK. THE SASK COMMITMENT COULD APPLY STRICTLY TO PRODUCTION WHICH GOS ITSELF WILL SOON OWN (PERHAPS ONE-FOURTH OF THE PROVINCE'S TOTAL CAPACITY, OR 2 MILLION ST). IT COULD BE ACCOMPANIED BY A GOS STATEMENT THAT IT INTENDS TO FOLLOW NORMAL BUSINESS PRACTICES IN OPERATING ITS HOLDINGS, AND THAT IT WOULD NOT SEEK TO INFLUENCE THE MARKET UNDULY.

9. ALTHOUGH THE PROPOSED SUPPLY ASSURANCE WOULD BE UNILATERAL, BENEFITS COULD ACCRUE TO BOTH SIDES. US CONSUMER INTERESTS WOULD GAIN BY LIMITING THE SCOPE OF GOS INTERVENTION IN THE POTASH MARKET. A GOS GUARANTEE COULD PROTECT THE US FROM PRICE GOUGING AND REDUCE THE URGENCY OF EXPLORING HIGHER COST ALTERNATIVE SUPPLY SOURCES. THE OUTLOOK FOR US INVESTMENTS IN SASK WOULD ALSO IMPROVE WITH A MORE EXPLICIT GOS COMMITMENT TO OPEN MARKET POLICIES. FROM REGINA'S STANDPOINT, SUCH AN ASSURANCE COULD SOLIDIFY THEIR US MARKET SHARE BY LOWERING THE INCENTIVE FOR THE US TO DEVELOP OTHER SUPPLY SOURCES. IMPROVED GROWTH PROSPECTS WOULD IN TURN ENCOURAGE INVESTMENT IN CAPACITY EXPANSION. IN SUM, A UNILATERAL SUPPLY ASSURANCE COULD REDUCE MUTUAL UNCERTAINTY AND THUS CONTRIBUTE TO GREATER MARKET STABILITY.

10. SHORT OF SOME SUCH SASK INITIATIVE THAT DOES NOT ENCUMBER THE MARKET OR THE USG, WE WOULD PREFER TO PROCEED WITHOUT ANY ASSURANCES, EXCEPT AS PRIVATE AMERICAN FIRMS MAY FREELY CONTRACT WITH SASK. YOUR INFORMAL DISCUSSIONS WITH BLAKENEY PROVIDE AN EXCELLENT OPPORTUNITY AT LEAST TO FORGE COMMON UNDERSTANDING ON THE NATURE OF THE WORLD POTASH MARKET AND SASKATCHEWAN'S RELATIVE POSITION. SASK LEADERSHIP

IN THE INTERNATIONAL POTASH MARKET IS A RECENT PHENOMENON BUT NOT NECESSARILY PERMANENT. IF UNDERLYING TRENDS IN PRODUCTION AND TRADE CONTINUE TO DEVELOP AS WE HAVE PROJECTED, SASK COULD FACE EROSION OF ITS MARKET POWER. GOS MANIPULATION OF THE MARKET WOULD NOT ONLY HASTEN THOSE TRENDS, AND THEIR DAMAGING CONSEQUENCES FOR THE SASK ECONOMY, BUT WOULD ALSO HARM THE US BY PUSHING UP PRICE LEVELS. FUNDAMENTALLY, THE MOST DURABLE KIND OF "SUPPLY ASSURANCE" WOULD BE A GOS COMMITMENT TO REFRAIN FROM EXCESSIVE TAMPERING WITH PRICES AND OUTPUT, AND TO PROMOTE A HEALTHY COMPETITIVE ENVIRONMENT. CONFIDENTIAL

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IF THAT IS TOO MUCH TO EXPECT FROM GOS AT THIS STAGE, WE WOULD DO WELL TO PRESERVE MAXIMUM FLEXIBILITY FOR BOTH THE USG AND PRIVATE BUSINESS IN ASSURING POTASH SUPPLY.

11. WE WOULD BE INTERESTED IN YOUR VIEWS ON THE ABOVE MARKET ANALYSIS, THE MERITS OF UNILATERAL ASSURANCES BOTH FOR US AND FOR SASK, AND REGINA'S PROBABLE REACTION TO SUCH A SUGGESTION. ROBINSON

NOTE BY OC/T: POUCHED WINNIPEG.

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